Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-111

PEOPLES NATIONAL BANK OF NEW JERSEY,
Petitioner,

vs.

JOHN B. FOWLER, JR.

and

MAURICE L. STONEHILL,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE
SUPREME COURT OF NEW JERSEY

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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JURISDICTION

Petitioner has sought to invoke the jurisdiction of this Court under 28 U.S.C.A. Section 1257(3) contending that there is a federal question. Respondent submits that jurisdiction is lacking in this case because the decision of the Supreme Court of New Jersey rests upon non-federal grounds and said decision is not properly reviewable in this Court. This point is pursued more fully in the Argument that follows.

QUESTIONS PRESENTED

1. Whether the following determination of the Supreme Court of New Jersey:

> Where an uncompensated guarantor's obligation contemplated a bank loan that would be made in accordance with the law and a bank enters into a loan contract violating both the State's usury law and the U.S. Securities Exchange Act of 1934, the Bank's violation discharges the guarantor's obligation and the owner of stock pledged as collateral is entitled to the return of that collateral

can or should be reviewed by this Court?

2. Whether the jurisdiction of this Court can be invoked properly where the above-stated final decision of the State Court rests on grounds which are non-federal in character or upon two grounds—one of which is non-federal in character and sufficient to sustain the determination below?

STATEMENT

Most of the applicable facts of this case are stated sufficiently in the decision of the Supreme Court of New Jersey (Petitioner's Appendix A at 1a to 7a).

To assist the Court in its consideration of this matter, however, we would emphasize the following specific points:

1. This is a suit which was originally instituted by petitioner in the State courts of New Jersey. Defendant, Fowler, removed the case to the Federal courts on the grounds of diversity of citizenship. Petitioner resisted this removal and the case was then remanded to the State court (Petitioner's Appendix C at 24a, fn. 1).

2. Respondent Stonehill filed an action in the United States District Court and sought to enjoin proceedings before the State court before the trial of this matter. The injunction was denied (Petitioner's Appendix C at 24a fn. 1).

3. Respondent Stonehill also moved, before the trial of the matter, to have the matter dismissed by the State court on the grounds that jurisdiction was properly in the Federal courts because of the alleged violations of the Securities Exchange Act of 1934. Petitioner also opposed this effort of defendants. The trial court reserved decision on this motion until the completion of the trial at which time it issued an opinion that the State court had jurisdiction to hear the matter (Petitioner's Appendix C at 24a to 26a).

4. The question passed upon by the Supreme Court of New Jersey was stated by that Court to be:

> "Is an owner of stock, which had been transmitted to a bank as collateral security for a loan to a third person, entitled to the return of the stock because in

making the loan the bank violated the Federal margin requirements of Regulation U, 12 C.F.R. Section 221.1 *et seq.* (1976), and the Usury Law of New Jersey, N.J.S.A. 31:1-1 et seq.?" (Petitioner's Appendix A at 1a)

5. As the opinion of the State Supreme Court indicates, the trial court found Regulation U had been violated and on oral argument before the Supreme Court petitioner conceded that violation. The question as to whether there was a violation of Regulation U was therefore not addressed by that Court but accepted as a fact (Petitioner's Appendix A at 2a, fn. 1).

6. The Supreme Court of New Jersey made the following determination with regard to the above question:

"It is a general rule that, if the condition upon which the guarantor agrees to become bound is not complied with, the guarantor is discharged. *Brandt, Law of Suretyship and Guarantee*, Section 350, at 471 (1878). We find that where the uncompensated guarantor's obligation contemplated a bank law which would be made in accordance with the law, the bank's violation discharges that obligation and the pledgor is entitled to the return of his stock." (Petitioner's Appendix A at 14a)

The opinion of the State Supreme Court also notes at that point that a comparable rule may be found in Section 124(1) of the *Restatement of Security* (1941), which states:

"Where before the surety has undertaken his obligation the creditor knows facts unknown to the surety that materially increased the risk beyond that which the creditor has reason to believe the surety intends to assume, and the creditor also has reason to believe that these facts are unknown to the surety and has a reasonable opportunity to communicate them to the surety, failure of the creditor to notify the surety of such facts is a defense to the surety."

ARGUMENT

Respondent submits that this Petition for a Writ of Certiorari should be denied:

Because the State court decision here under review rested upon grounds which are essentially non-federal in character and said decision is not dependent upon a federal ground for its substantiation;

The assertion that the State court decision extended the application of 15 U.S.C.A. Section 78cc(b) to one *not in privity of contract* with a lending bank is contrary to the determination reached by the State court and such a determination, whether factual or legal in nature, is essentially non-federal in character and not subject to review (Petitioner's Appendix A at 8a);

Petitioner's contention that the State trial court decision is contrary to the determination in *Natkin v. Exchange National Bank of Chicago*, 342 F.2d 675 (7th Cir. 1965) is not correct and such an issue, in any event, does not warrant review by this Court under the facts of this case.

1. *The absence of a non-federal question.*

It is clear beyond question that the jurisdiction of this Court cannot be invoked in the fashion here attempted by petitioner in the absence of a federal question. Moreover, where the judgment of a State court rests upon two grounds, one of which is federal and the other non-federal in character, this Court is also without jurisdiction to review if the non-federal ground is independent of the federal ground and adequate to support the judgment. This is true even if the State court may have also summoned to its support an erroneous view of federal law. *Radio Station WOW v. Johnson*, 326 U.S. 120, 65 S. Ct. 1475 (1945); *Jankovich v. Indiana Toll Road Com.*, 379 U.S. 487, 85 S. Ct. 493 (1965); *Henry v. Mississippi*, 379

U.S. 443, 85 S. Ct. 564 (1965), 32 Am. Jur. 2d Federal Practice and Procedure, Section 243.

In this case, the State Supreme Court posed very clearly the question it was passing upon and its response to that question is equally clear. In essence, the New Jersey Court determined, under its interpretation of general doctrines of the law of suretyship and guarantee, that an owner of stock which has been transmitted to a bank for collateral security for a loan to a third person is relieved from his surety or guarantor obligations where the bank has violated certain provisions of the law in making the loan to the third person. Herein, the actual violation of Regulation U of the Securities Exchange Act of 1934 as well as the usury laws of the State of New Jersey.

In the above holding, the State court opinion does not rest upon the provisions of the Securities Exchange Act of 1934 or more specifically the provisions of that Act concerning violations set forth in 15 U.S.C.A. Section 78cc(b). There is nothing in the opinion below to sustain petitioner's contention that the State court decision here under review rested upon or was dependent upon the application of this section of the federal law. Indeed, the decision below indicates specifically that it is grounded on doctrines of suretyship and guarantee as is revealed by the citations of the court to *Brandt, supra,* and the Restatement of Security (Petitioner's Appendix A at 14a).

The State court had full right and power to determine the application of these doctrines to the loan transaction in question and such concepts of contract and surety law are so essentially non-federal in character so as not to sustain a review of this matter by this Court under the provisions of 28 U.S.C.A. Section 1257(3).

2. *The issue as to privity of contract.*

In seeking to fabricate the contention that there is a federal question here present which would enable petitioner to at least cross that threshold issue, petitioner has asserted that the State court decision here under review "extended the application of 15 U.S.C.A. Section 78cc(b) to one not in privity of contract with a lending bank" (Petitioner's brief p.8).

The issue of privity of contract, as the words imply, is basically a question of contract law. It is also a question of fact. These questions, however, are not essentially federal in character. Moreover, the determinations made by the State court below on these questions are not only correct but are also so narrow and unique to the state of facts present in this case so as not to warrant the attention of this Court.

The response to petitioner that no privity of contract existed in this case is best answered by the opinion of the Supreme Court of New Jersey which states:

> "The factual conclusion that Stonehill had no contractual or other legal relationship with PNB is belied by the undisputed facts. PNB knew that the stock which was being pledged by Fowler was owned by Stonehill. This was evident from Fowler's February 24, 1971 letter to Rohrer (which was received before the loan agreement was made on March 1) in which Fowler advised Rohrer that not only was the stock owned by Stonehill but also that Stonehill was a controlling stockholder. Because this was control stock, under Rule 154 of the Securities and Exchange Commission, promulgated pursuant to the Securities Act of 1933, only limited quantities could be sold on the American Stock Exchange, where the stock was listed, every six months 19 Fed. Reg. 9375-9376 (1954). Furthermore, at the closing PNB received a letter

> signed by Stonehill in which he authorized the use of the stock as collateral for the loan. And Francis Mason, PNB's Vice-President, was advised by Chemical of the stock's status when arrangements were being made for transmittal of the stock certificates and satisfaction of the Fowler indebtedness to Chemical.
>
> Stonehill was joined as party defendant to this litigation because PNB recognized that he was a necessary party. Stonehill's interest in the transaction, as owner of the pledged stock and as surety or guarantor to the extent of the pledged stock, is apparent."

The Court opinion goes on at some length to review the legal rights that Stonehill had by virtue of his position as a surety or guarantor with regard to the lending bank. Its conclusion that Stonehill had standing to raise defenses and assert his claim to the stock is not grounded upon an interpretation of federal law and such a finding. whether deemed to be factual or legal in nature, is not subject to dispute before this Court. *Neblett v. Carpenter*, 305 U.S. 297, 59 S. Ct. 170.

As a final point, the determination by the State Supreme Court in this matter on this issue of privity of contract is so patently correct that even if this were deemed to be a reviewable question, petitioner has most obviously failed to set forth a justification for a review of the matter.

3. *The decision below does not conflict with the* Natkin *decision in such a manner as to justify a review of this case.*

Assuming *arguendo* that petitioner can satisfy this Court with regard to the threshold issues set forth in Points I and II hereof, its contentions that the New Jersey decision conflicted with the determination in *Natkin v. Ex-*

change National Bank of Chicago, supra, is without foundation.

In *Natkin*, it was conceded by the parties that there was "no contractual relationship between the bank and the plaintiffs and that the plaintiffs are strangers to the loan transaction . . ." 342 F.2d *supra* at 676. The case was decided on this agreed statement of facts.

Unlike the situation in *Natkin*, the lending bank in this case was well aware of Mr. Stonehill's ownership of stock and the fact that it was control stock. Moreover, respondent's stock was pledged as collateral by a written hypothecation agreement from Stonehill to the lending bank (Petitioner's Appendix A at 11a). No such similar situation existed in *Natkin*.

In *Natkin*, the owners of the collateral stock were true strangers to the transaction. They permitted the borrower to deal with the bank under circumstances where the bank had no basis for assuming that anyone other than the borrower was the owner of the stock. There was no recognition in *Natkin*, as is the case here, of a third party ownership of the stock and no comparable relationship between the lending bank and the stock owner by way of hypothecation agreement. The New Jersey's Courts determination, therefore, that *Natkin* was distinguishable from the present situation therefore was correct and certainly does not raise such an issue of federal law that would warrant further review by this Court. Additionally, the interpretation of *Natkin* followed by the New Jersey Court was clearly in accord with federal law.

Although petitioner has cited in its petition *Levin v. Great Western Sugar Co.*, 274 F. Supp. 974 (D.C.N.J. 1967) and *East Side Church of Christ v. National Plan, Inc.*, 391 F.2d 357 (5th Cir. 1968), it has conveniently neglected to note that both of these decisions are con-

sistent with or supportive of the interpretation followed by the Court below. In *East Side, supra,* the Circuit Court of Appeals expressly recognized the right of the equitable owners of securities to maintain an action under the Securities Exchange Act of 1934 although these owners did not participate in the transaction between their agent and the broker to whom he sold the securities. 391 F.2d *supra* at 362.

The decision in *Levin, supra,* is also consistent with the interpretation of *Natkin* by the Court below. In *Levin,* the stockholders of one company involved in a proposed merger of corporations sought to attack certain loans made to the corporation seeking to acquire the company in which they held stock. Neither these stockholders nor their company were parties to the loans made by the banks to the other company. Under these circumstances, the stockholders were held to be strangers to the bank loan transactions. In explaining its ruling, the Court states at 274 F. Supp. 979:

> "Although it could be argued that the privity requirements enunciated in those cases are ripe for change, or for waiver in the present case, two considerations compel an opposite conclusion: (a) the plethora of suits against banks that might follow from a relaxation of the rule, and the consequent adverse effect on banking and commerce, (b) the fact that, in any event, the facts of the present case do not indicate that a waiver of the rule for the present plaintiff would be proper or equitable at the present time."

The reference to the plethora of suits clearly underscores the rationale of the *Natkin* decision. If individuals who are not connected with bank loan transactions could, after the fact, litigate whether the loans violated the federal law, there is a clear danger of extensive litigation.

The present situation is clearly distinguishable. Defendant Stonehill was, in fact, a party to the loan transaction by virtue of his hypothecation agreement with the bank. The interpretation followed by the State Court is clearly consistent with all federal decisions on this point.

It should be apparent, therefore, that petitioner is seeking to litigate an issue which is essentially non-federal in character. To the extent that it may be concluded an interpretation of the Securities Exchange Act of 1934 is involved in the decision below, however, the interpretation followed by the State Court is consistent with the federal decisions on the point. Although the Supreme Court of New Jersey's decision is not dependent upon an interpretation of *Natkin* or upon the remedy set forth in 15 U.S.C.A. Section 78cc(b), the decision below is fully consistent with existing federal decisions in these areas.

As a final note, petitioner has challenged the role played by the New Jersey Court in this matter. It should be noted that petitioner repeatedly resisted efforts by the defendants below to place this matter before the Fedral courts. It actively sought State court review. It should not be permitted to use the involvement of the State courts in a "federal" matter as part of the rationale for review by this Court.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari that has been filed in this case should be denied.

Respectfully submitted,

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